Auto Track

H2 FY20
April 2020

Automotive and Manufacturing

Brand visibility

Opportunity

Contents

Foreword

Despite the global disruption and unprecedented challenges arising out of COVID-19 crisis, the post-COVID world would see digital technologies play a critical enabling role in delivering improvements throughout the breadth of the industry.

2019 was a tough year for the automobile industry due to a global economic slowdown and falling Gross Domestic Product (GDP) in India. Due to lowered consumer spending and reduced private investments, the GDP growth was down to 4.5% in Q3 2019 from 5% in Q2. But as we looked forward to the year 2020 with great optimism, a crisis like no other had emerged. The coronavirus disease (COVID-19) pandemic has left the world so crippled that it will take months before businesses can resume operations in full swing.

In the wake of the ongoing crisis, many uncertainties have come into the picture across industries. The repercussions of nationwide lockdown announced on 22 March 2020 are already visible in the March 2020 sales figures of the Indian auto sector. The question of reopening the economy is more about, 'if not now, then when'. It is crucial to tread with caution till the healthcare infrastructure is strengthened to deal with this unprecedented health emergency.

The manufacturers of auto components are unable to manage their working capital as they have to bear fixed costs with stressed short-term viability. The lockdown could further lead to job losses, salary cuts and freeze on hiring over the next few quarters, distressing industry employability. While original equipment manufacturers (OEMs) have reassured the government that no workforce would be retrenched, reprioritising projects could be challenging under these circumstances. Meanwhile, some automobile start-ups have already announced lay-offs and salary cuts.

If one keeps aside the challenges arising out of COVID-19 crisis, this phase could turn out to be an opportune moment for the OEMs and component manufacturers, who could make in India and mitigate the risk of labour shortage when the situation turns normal. The relief measures taken by the Reserve Bank of India (RBI) to support the automobile industry may improve liquidity. We are hopeful that the central bank would take more necessary and timely steps to provide further support. However, the three-month moratorium on all term loans does not seem to be beneficial for the auto dealers due to their needs of short-term borrowing. Thus, the inventory financing partners of OEMs can be requested to extend the moratorium to dealers. To provide relief to auto dealers, some OEMs have announced taking the ownership of unsold stock. Timely payments to component manufacturers by OEMs are also important to avoid liquidity crunch.

If the pandemic threat does not recede in the second half of 2020, it could lead to longer containment periods, worsening financial conditions and leading to breakdowns in global supply chains. Policymakers will need to implement many targeted fiscal, monetary and financial market measures to support affected households and businesses. The product development schedules of the industry could go haywire. OEMs are inclined to conserve cash to keep the working capital going and reset the production cycles invoked with force majeure and not honour all the upcoming deadlines. Since April and first week of May 2020 could well be recorded as 'no production' months, the industry will have to consider a massive shift to digital channels for converting leads into sales among others.

Despite the global disruption and unprecedented challenges arising out of COVID-19 crisis, the post-COVID world would see digital technologies playing a critical enabling role in delivering improvements throughout the breadth of the industry. These may include more resilient supply chains, significantly enhanced user-experiences and intelligent optimised processes to deliver business outcomes.

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Key highlights from the publication

Industry overview: Domestic sales and export trends

The section talks about sales and export trends from October 2019 to March 2020. The industry was optimistic due to the positive sentiments witnessed during the festive season. It was hopeful of a structural recovery in the market. The COVID-19 crisis has given the automobile industry time to introspect. In the next five years, the industry should look at doubling its exports as Chinese dominance on the rest of the world will be challenged.

Impact of COVID-19 on the industry

The coronavirus disease (COVID-19) pandemic has brought forth unprecedented challenges to every sector. The automobile industry, which was already battling its worst slump in two decades, has had its share too. This section delves into the impact of the pandemic and subsequent lockdown on the industry, and what the industry should be ready for post-COVID.

Story of the quarter

New strategies to drive domestic sales: As the automobile industry plays an important role in the GDP, measures are being taken to change the industry's perspective, the way it works and to drive domestic sales.

Coverage

An analysis of the year-to-date capital expenditure (capex) figures of large-, mid-, and small-cap automobile companies shows another story of growth for Indian automobile industry. The rapid spread of COVID-19 in India is likely to impact domestic consumption and production including shocks to investments.

Regulatory updates

The Union Budget 2020 announced a long-to-medium-term remedy. The focus was primarily on digitising India - implementation of technology in umpteen sectors, infrastructure and accelerated development of highways. In other updates, the highest number of vehicle safety norms were made mandatory for compliance in 2019, making automobiles in India safer and in-line with the global standards.

Industry overview

Year-on-year (y-o-y) comparison of the number of units sold

Segment	January 2019	January 2020	% change	February 2019	February 2020	% change	March 2019	March 2020	% change
PVs	280,091	262,714	-6.20	272,243	251,516	-7.61	291,861	140,910	-51.72
CVs	87,591	75,289	-14.04	87,436	58,670	-32.90	109,022	13,027	-88.05
3Ws	54,043	60,903	12.69	59,875	41,300	-31.02	66,274	27,608	-58.34
2Ws	1,597,528	1,341,005	-16.06	1,614,941	1,294,791	-19.82	1,440,593	866,849	-39.83
Total	2,019,253	1,739,975	-13.83	2,034,597	1,646,332	-19.08	1,908,097	1,048,263	-45.06

October-December 2018	October-December 2019	y-o-y growth
6,149,750	1,739,975	-12.61

PV: Passenger vehicle
CV: Commercial vehicle
2W: Two-wheeler
3W: Three-wheeler

Domestic sales trends - H2 FY20

- Industry had high hopes after Union Budget 2020 announcements - signs of growth and more investments in the sector.
- Industry remained optimistic due to positive sentiments witnessed during the festive season. It was hopeful of a structural recovery in the market.
- Relatively muted sales performance in January could be attributed to initial efforts of by original equipment manufacturers (OEMs) to ramp down BS IV vehicles and move to BS VI norms.
- Preventive production cut by OEMs with the objective of BS VI transition and disruption caused by COVID-19 in supply chain severely impacted the performance of domestic auto industry.
- Decline in wholesale dispatches was seen primarily due to the ongoing economic slowdown and lower production of BS IV vehicles.
- The COVID-19 crisis further added to the subdued demand and consumer sentiment.

March 2020

The nationwide lockdown from 22 March 2020 halted production and led to a 45% y-o-y decline in sales. PV sales declined 51% to 143,014 units while sales of CVs came down by 88% to 13,027 units. Those of 2Ws fell by 40% to 866,849 units.

February 2020

Total PV sales fell 7.61% to 2,51,516 units and total PV production declined 9.43% to 3,04,217 units. PV exports jumped 8.86% to 55,437 units. Passenger car domestic sales dived to 156,285 units from 171,307 units registered in the same month in 2019.

January 2020

Low consumer sentiments led to slowdown in sales. CVs sales came down by 14.04% to 75,289 units from 87,591 in January 2019. Similarly, PV sales declined by 6.20% to 2,62,714 units from 2,80,091 in January 2019. In 3Ws, the buying interest continued to be better than other segments resulting in 12.69% y-o-y growth.

December 2019

Sales of all segments plummeted compared to the same month in December 2018, except for the 3Ws segment, which showed a continued positive figure of 22.10% on a y-o-y basis.

November 2019

PV segment registered a marginal drop of 0.84% in domestic sales from 263,773 units compared to 266,000 units sold in November 2018. 2Ws too had seen a drop of 14.27% in domestic sales last month with 1,410,939 units sold compared to 1,645,783 units recorded in the corresponding month the previous year. However, the 3Ws segment registered a positive figure with 4.45% growth with 55,778 units sold last month, compared to 53,401 units registered in November 2018.

October 2019

The festival month led to the PV segment showing 0.28% y-o-y change. Manufacturers' off-take of cars at dealers was much better during the month indicating an effort at clearing the inventory. Retail numbers were seen to be higher for OEMs.

Domestic sales trend

Month	PVs	CVs
October 2019	0.28	-23.31
November 2019	-0.84	-14.98
December 2019	-1.24	-12.32
January 2020	-6.20	-14.04
February 2020	-7.61	-32.90
March 2020	**-51.72 (COVID-19)**	**-88.05 (COVID-19)**

*The data in the table shows the y-o-y % change in PV sales in India and y-o-y % fall in CV sales in India

Exports trend

Month	Number of vehicles	y-o-y % change
October 2019	395,964	2.72
November 2019	411,470	17.60
December 2019	410,449	8.75
January 2020	396,704	15.02
February 2020	415,329	11.05
March 2020	286,032	**-24.51 (COVID-19)**

Our view

The COVID-19 crisis has given the automobile industry time to introspect. In the next five years, the industry should look at doubling its exports as Chinese dominance on the world will be challenged.

Impact of COVID-19 on the industry

Worldwide repercussions

Global GDP will shrink by 3% in 2020: IMF

International Monetary Fund (IMF) has projected that income per capita in over 170 countries will shrink in 2020 due to COVID-19 pandemic. It has further projected the growth in advanced economies to be -6.1%, while emerging market and developing economies with normal growth levels to have negative growth rates of -1.0% in 2020, and -2.2% with China excluded.

Calling it a “truly global crisis”, the IMF’s chief economist had said, the pandemic could cause a cumulative loss of around USD 9 trillion to the global GDP over 2020 and 2021, greater than the GDP of Japan and Germany, combined.

Global economy could shrink by almost 1% in 2020: UN

Falling GDP

Country-wise forecasted percent change in GDP due to COVID-19

China	-2.4%
Japan	-2.7%
Indonesia	-4.6%
Germany	-3.6%
USA	-2.4%
Russia	-4.8%
Brazil	-3%
India	-0.8%

COVID-19 impact on global automobile industry

Country	Vehicle sales		% change (E)	Current scenario
	2019 (units in million)	2020 (units in million)		
China	25.7	23.5	-8.6%	Plants opening up. Footfalls in retail showroom increasing. Recovery expected during 2020.
USA	17.6	14.0	-20.5%	Major automakers announced indefinite shutdowns. Automobile production has come to a standstill.
Europe	18.3	16.0	-12.6%	Rise in COVID-19 cases is affecting regional demands.
Rest of the world	28.4	26.4	-7.0%	Extension of nationwide lockdown in India. Disrupted supply-chain and fall in consumer confidence.
Total	90.0	79.9	-11.2%	Significant high-level impact on global sales numbers.

Combined with disruption in several manufacturing and services sectors, estimates for economic loss in 2020 will be close to USD 234.4 billion or 8.1% of GDP: Barclays

Falling oil price

The worldwide lockdown due to COVID-19 has brought transportation across land, water and air to a standstill. Consequently, there's been a fall in oil demand.

Weakness in oil prices implies lower fiscal revenues, lower spending by the government, lower support of the non-oil sectors, lower revenues flowing to the sector and hence, lower growth for the oil exporters. Further, the exporters will be forced to drastically reduce aggregate spending that could weigh on global economic activity.

Our view

The push for electric vehicles (EVs) could take a back seat despite the government's initiatives. The industry, which has invested in BS VI vehicles, will have to delay the introduction of EVs for now in order to maintain its current stock of inventory and cash. Two-wheeler sales could likely see some progress compared to pre-lockdown days.

Disruption in supply chains

Developing a cogent supply chain response in these times is extremely challenging. The industry has experienced severe disruptions due to overdependence on China as a manufacturing base. Some countries have already started shifting their manufacturing base to countries other than China. For instance, Japan has earmarked USD 2.2 billion to help companies shift manufacturing base from China to Japan and USD 214 million to other countries.

Our view

Automakers should now review their supplier strategy across geographies and possibly rely more on indigenous suppliers. The impact for India will have to be re-assessed continuously based on spread and containment of COVID-19.

No longer business as usual

	Nov '19	Dec '19	Jan '20	Feb '20
Manufacturing purchasing manager's index	50.2	50.2	50	35.7
New orders index	51.3	51.2	51.4	29.3
New export orders index	48.8	50.3	48.7	28.7
Finished goods inventory index	46.4	45.6	46	46.1
Import index	49.8	49.9	49	31.9
Raw materials inventory index	47.8	47.2	47.1	33.9
Employment index	47.3	47.3	47.5	31.8
Non-manufacturing business index	54.4	53.5	54.1	29.6

All data units are in %

Purchasing manager index above 50% reflects the manufacturing economy is expanding; less than 50% reflects the manufacturing company is shrinking.

New orders index month-on-month changes in the diffusion index based on the number of orders received by enterprises

Source: National Bureau of Statistics, China

Impact on each vehicle segment

COVID-19 has slowed down the industry further shortly after it had already witnessed 16% sales slump in the first 11 months of FY20. Lockdown has reduced discretionary purchases and the trend is expected to continue through the first half of 2020.

How the industry could fair

	Optimistic	**Realistic**	**Pessimistic**
	Rapid recovery, growth returns to normal	Shock breaks growth trend	Real structural damage
PVs	Growth to be 8-10% negative	Growth to be 10-14% negative	Growth to be 16-20% negative
CVs	Growth to be 14-17% negative	Growth to be 19-23% negative	Growth to be 25-30% negative
2Ws	Growth to be lower by about 10-12%	Growth to be about 16-20% negative	Growth to be about 20 to 24%

* The estimates are done based on the situation as on 20 April 2020. These are likely to change.

Impact of extended lockdown on the Indian auto industry

The unprecedented crisis stemming from COVID-19 makes it highly concerning for the Indian auto industry. Experts believe the pandemic may not recede in the second half of the year and this could lead to longer containment periods, worsening financial conditions and leading to further breakdowns in global supply chains. According to industry estimates, the lockdown could result in losses to the tune of INR 48,000 crore. Society of Indian Automobile Manufacturers (SIAM) estimates plant closures of various auto OEMs and components companies could lead to a loss of more than INR 2,300 crore in turnover for each day.

A timeline of COVID-19 lockdown in India

01

22 March

14-hour voluntary public curfew

02

24 March

Nationwide lockdown announced for 21 days

03

27 March

The Supreme Court granted a conditional extension of the BS IV deadline. Dealers across the country, except those in Delhi-NCR, allowed to sell 10% of their BS IV stocks for up to 10 days after the end of nationwide lockdown

04

29 March

Free services, normal and extended warranties expiring between March 15 and April 15 extended till June 2020

05

31 March

A notification issued by the Ministry of Road Transport and Highways to extend the validity of driving licences and vehicle registrations expiring between 1 February and 30 June 2020

06

2 April

Government provided an extension for the renewal of motor vehicle insurance until 21 April 2020

07

8 April

Hyundai India made its 'Click to Buy' - online car sales platform available pan-India

08

9 April

Uber announces a series of measures to deliver mobility solutions for essential services. It will provide 150 vehicles to hospitals free of cost in seven cities for ferrying medical staff

09

13 April

Tata Motors launches its digital sales platform 'Click to Drive', which allows customers to purchase a car from their portfolio without having to step out of their home

10

15 April

Nationwide lockdown extended till 3 May 2020

11

16 April

Ministry of Finance extends third-party auto insurance renewal deadline to 15 May 2020, and is applicable in cases where insurance expires between 25 March and 3 May 2020

Our view

Policymakers will need to implement substantial targeted fiscal, monetary, and financial market measures to support affected households and businesses. Lockdown extension will likely delay the registration deadline for BS IV vehicles that were sold but not registered prior to 31 March 2020. The window for sale available to automobile retailers for selling their remaining BS IV stock is also likely to be deferred.

2020 Geneva Motor Show, to be opened on March 5, 2020 got cancelled.

Industry aids relief measures

Several automakers have stepped up to use their expertise in parts production to help the medical industry. The industry has also cancelled all major events or taken the digital route to connect with stakeholders.

Company	COVID-19 relief measures
Hyundai Motor India	Working towards the provision of personal protective equipments (PPEs) to appropriate authorities in Delhi, Tamil Nadu, Haryana and Maharashtra • Donated a sum of INR 7 crore to the PM CARES Fund. • Pledged another INR 5 crore to the Tamil Nadu Chief Minister's Relief Fund. • Partnered with Air Liquide Medical Systems to increase production and supply of ventilators in India. • Handed over advanced diagnostic testing kits, worth INR 4 crore, to the Indian Council of Medical Research (ICMR).
Maruti Suzuki	• Conducted various community outreach programmes to support villages around its Gurugram and Manesar plants in Haryana. • Established in-house kitchens at its manufacturing facilities. • Proactively working with the India Red Cross Society. • Making potable water available at very nominal rates across 16 villages through 17 of its water ATMs. • Provided 16 waste collection vans for village sanitisation in Manesar and Rohtak and supplied face masks and other protective equipment through the Gurugram administration.
Hero Group	• To contribute INR 100 crore as aid for the ongoing COVID-19 relief efforts in India.
BMW Group	• Provided critical care equipment to medical facilities and PPEs to medical personnel and law enforcement agencies in Delhi-NCR and Chennai.
Volkswagen India	• Will be contributing to the PM CARES fund for every car it delivers to healthcare professionals. • Started virtual training of its dealership teams to ensure best sanitisation and hygiene practices once operations resume.

Skoda Auto Volkswagen India Private Limited	• To donate INR 1 crore to the Sassoon General Hospital in Pune for establishing a dedicated COVID-19 facility with 1,100 beds. • To provide 35,000 sanitisers to hospitals in Pune, Aurangabad, and Mumbai, and distribute food packets among the underprivileged in the Aurangabad. • The group is producing reusable face shields at its Chakan factory, which will be a part of PPE for medical workers. • The company is also said to be attempting to tap into its global supply chain to organise essential medical supplies for India.
MG Motor India	• As part of its Developer Programme, the company will make affordable ventilator. • President and MD have contributed one month's salary towards coronavirus relief aid.
Mercedez Benz	• To support 1,600 daily-wage workers and below poverty line families from Khed and Viman Nagar areas in Pune by providing them with dry ration and cleaning kits. • To set up a temporary hospital in Pune, with a 1,500-bed isolation ward for COVID-19 patients.
Toyota Kirloskar Motor (TKM)	• Announced a series of measures to alleviate the stress of lockdown on its dealer partners. • Targeted at ensuring liquidity to sustain the business during the lockdown by protecting dealers for approximately 38-75 days by giving cash-flow support. • Plans for a one-time reduction of inventory funding interest.
Mahindra & Mahindra	• Manufacturing face shields to limit potential exposure to coronavirus.
Tata Trusts	• Has earmarked INR 500 crore to empower and protect affected communities from COVID-19. • Providing PPEs, respiratory systems and testing ,kits and set up modular treatment facilities for patients.
TVS Motor Company	• Announced INR 30 crore economic aid package.
Bajaj Group	• Announced INR 100 crore COVID-19 pandemic relief package that aims to upgrade healthcare facilities as well as support initiatives to provide food and shelter to those in need. In addition, the company will also help those affected in rural areas by means of a special economic aid programme.

Building post COVID-19 preparedness

Challenges for the industry in India

Cost of production

OEMs will have to take stock of working capital needs. The pressure on banks to reduce lending will lead to downward pressures in the credit market. As supply from China takes a hit, it will result in degrowth in billing for auto dealers. There will be increased investments to either initiate indigeneous production or import components from other destinations.

Labour supply

Factory shutdown to affect daily wage earners and gig workers. There will be job losses, salary cuts and freeze on hiring over the next few quarters. Auto start-ups have already begun layoffs and salary cuts. It will be tough to trace migrant workers for work once the lockdown period ends.

Consumption demand

Winning consumer confidence will be key for the industry. Consumers might defer investments in new vehicles with focus shifting towards essentials due to COVID-19 crisis. There could, however, be a renewed interest in pre-owned vehicles market. There could also be rise in auto loan delinquencies due to weakened liquidity and credit concerns. Asset prices could decline.

Government expenditure

Government's support will be sought to liquidate BS IV stock. There could also be reduction in impact of taxes and duties. The authorities with may need to devise a long-term crisis management scenario. The automobile financial system too will need support. There could be increased spending on awareness and outreach.

Being business-ready

Plan for consistent lower cash flows and revenue

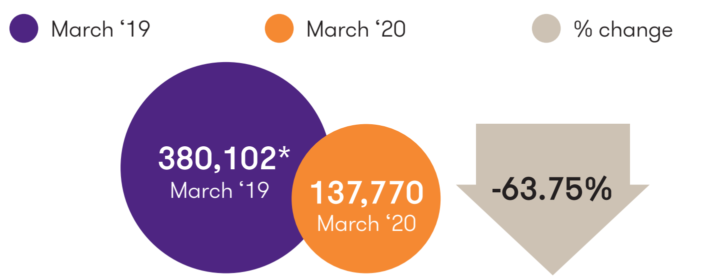
The OEMs are facing unforeseeable challenges on account of supply of auto components and parts from China that has reduced the inventory days for auto dealers resulting in high de-growth in billing for February 2020.

As manufacturers close operations to prevent the spread of the COVID-19 pandemic, 64% y-o-y decline was recorded in vehicles sales of top OEMs in March 2020 with only 1,37,770 units sold in comparison to 3,80,102 in March 2019.

Our view

Developing a cogent supply chain response in these times is extremely challenging, given the scale of the crisis. All manufacturers need to plan ahead for longer periods of lower cash flows and revenue.

Falling demand in March 2020 - Top Indian OEMs



*Total no. of units sold

Global used car market

Globally, the number of used cars sold via portals has dropped by 65% between 16 and 23 March 2020 in Italy. In the UK, which was late in implementing severe measures to combat the virus, the sale of cars experienced a 32% decline during the same period. In France, Germany and Spain, the decline is between 45% and 69% due to COVID-19 lockdown.

Our view

The numbers could decline substantially over the coming weeks as the short-term demand shock becomes more visible and dealers remain closed, with little activity on e-commerce sites.

Move towards the digital world

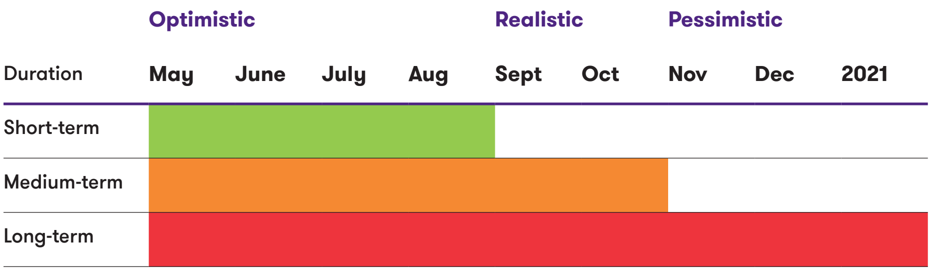
COVID-19 crisis is likely to accelerate digital transformation initiatives for businesses across the globe and will redefine global supply chains strategy.

Our view

Based on lessons being reinforced and validated in the current crisis, there are several ways in which businesses can go about creating resilient supply chains post COVID-19. First, reduce dependency on physical labour across transportation, logistics and warehousing. This can be enabled through technologies such as internet-of-things, blockchain, control towers, artificial intelligence/machine learning-enabled demand forecasting, rule-based and self-adjusting stock allocations, autonomous devices such as AGVs and drones, among others.

Conclusion

COVID-19 crisis will impact the global automobile industry for the next few years. The threat to lives and livelihoods will be resolved only when treatment to this deadly virus sees the light of the day. Manufacturing operations in India are likely to be resumed based on the zones - red, orange/yellow, and green.



Short-term response: Out of the crisis phase in the next one to three months

Solution: Situation to ease starting July 2020

Medium-term response: Out of crisis in the next three to six months

Solution: Situation to ease starting October 2020

Long-term response: Out of crisis in the next six to 12 months

Solution: Situation to ease starting next year

Story of the quarter

New strategies to drive domestic sales

Post the lockdown, future road for the industry looks bumpy.

Prior to the pandemic, governments focused on three areas to secure individual mobility. These were preservation of resources, environmental compatibility and safety of the individual. Consequently, OEMs began to build cleaner, safer and diverse range of vehicles, including, zero-emission ones. Most OEMs have been eyeing sustainable, profitable growth and not just volume. Yet endeavours are being made to eye for scale as fast as possible through acquisitions in either home market or matured markets across developed countries to establish a global presence.

Post the lockdown, future road for the automobile industry looks bumpy. With mobility and commuting needs of individuals and organisations reducing considerably as they evaluate their need to work from home (WFH), primary growth drivers of the Indian automobile industry – increasing demand for vehicles with disposable income at play – might change too.

Understanding consumer behaviour

The industry will have to increasingly focus on being customer-centric. During COVID-19 crisis, customers will defer buying decisions as they look to conserve cash. Many customers eye low-priced smaller vehicles. Affordable mobility with safety gears would be another prerogative. OEMs might have to craft new strategies by manufacturing vehicles that suit consumer preferences for safer transport.

Taking the e-route

Both businesses and consumers have understood that the e-commerce sector will flourish manifold as COVID-19 leaves its impact on consumer behavioural choices. Dealerships will make a move online to reach customers and convert leads into actual sales. OEMs would look to utlise manufacturing plants to optimum level and understand implications of government policies.

Impact on EVs

With auto fuel prices becoming more affordable, it's the traditional internal combustion engines that carry better value preposition over EVs. Here, the government's decision to decide the fuel tax structure and concessions on greener vehicles would create a major impact on consumer choices.

OEMs would recalibrate their strategies and drastically downsize the original production plan of making EVs. They would focus on reviving their existing operations and may look to utilise the Faster Adoption and Manufacturing of (Hybrid &) Electric Vehicles (FAME) subsidy. A strong rebound is possible in 2021 with nations employing stimulus measures to offset the virus's impact.

Our view

Many trends in the automobile industry are reinforcing the need to innovate and redefine supply chain strategies, layouts, and operations. Companies need a global view of demand to make decisions on capacity management, sourcing and profitable allocation of vehicle. Therefore, an effective and efficient global supply chain is a must-have for automobile manufacturers and their suppliers.

As the Indian automobile industry looks to globalise, the OEMs will need to rewire to devise strategies to meet the rising demands. From demand and supply misalignment, volatile raw material prices, to changing regulatory policies and shortage of qualified workers in the market, the industry's globalisation efforts will need a reality check.

A number of companies are looking to diversify, suggesting a manufacturing shift from China. India continues to be among the top destinations in Asia that could benefit from this manufacturing shift. The country needs policies that encourage innovate, make and buy in India.

Coverage

Capex investment trends

An analysis of the year-to-date capital expenditure (capex) figures of large-, mid-, and small-cap automobile companies shows another story of growth for the Indian automobile industry. The rapid spread of COVID-19 in India is likely to impact domestic production, consumption and investment trends.

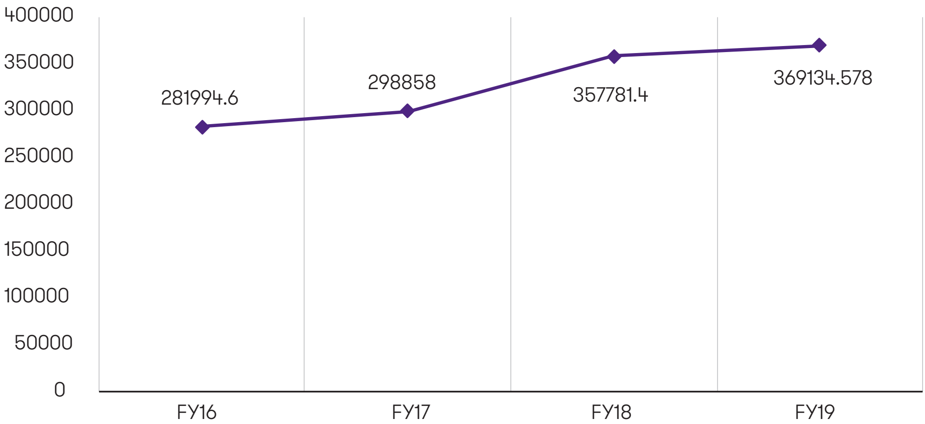
The primary focus now is on strategic sales and that means OEMs would get a better value and there will be open offers of fairly large amounts. To grow, what India's automobile sector really needs is lower interest rates and lower oil prices.

Capex figures of large-, mid-, and small-cap automobile companies (2016-19)

The large-cap companies have shown a growth in Capex figures during FY19 but not as much as FY17 and FY18 (approximately 19.71%). Macroeconomic factors like interest rate, inflation and good monsoon forecast had lifted the vehicle demand in FY17. The top auto companies such as Maruti Suzuki, M&M, Tata Motors, Ashok Leyland, Hero MotoCorp, TVS, Bajaj Auto etc. had played a key role in growth and development of the industry.

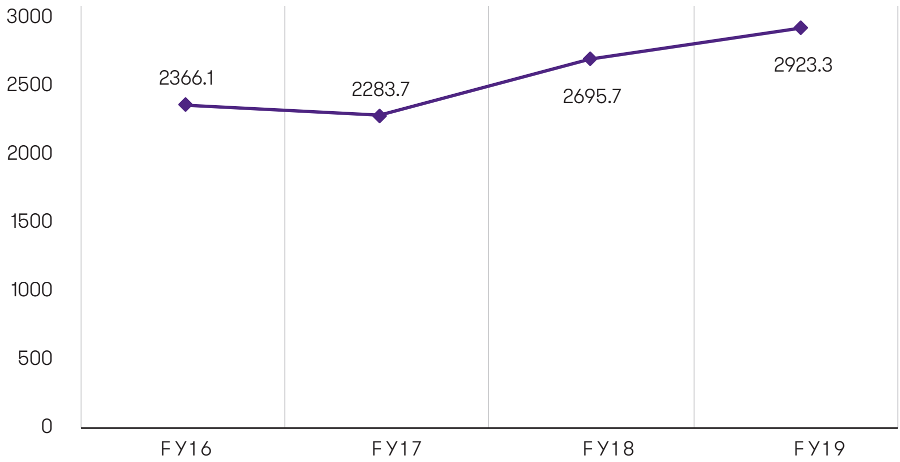
Now, OEMs are looking to fast-track plans for agile manufacturing processes and supply chains as they prepare for a volatile demand environment.

Large-cap



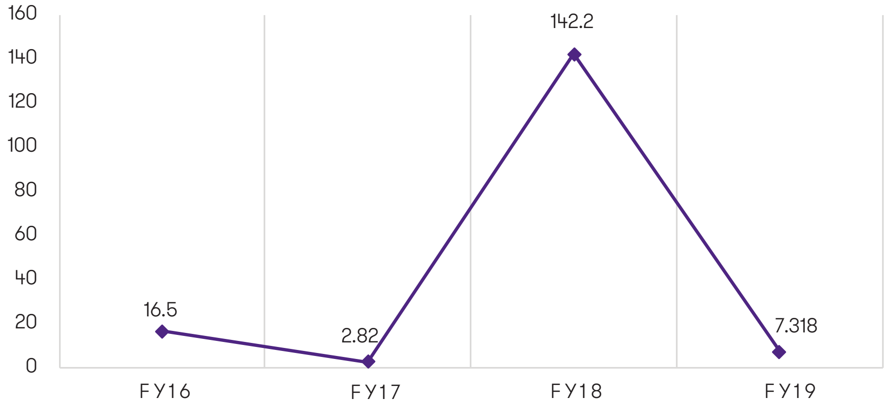
	March '19	March '18	March '17	March '16
MARUTI SUZUKI INDIA LTD.	47470.00	39116.00	32524	24686
BAJAJ AUTO LTD.	1635.30	1826.30	1994.4	2651.4
MAHINDRA & MAHINDRA LTD.	73400.10	59057.80	50261.5	41720
EICHER MOTORS LTD.	7890.00	7485.00	5477.3	4079.9
TATA MOTORS LTD.	174195.50	198654.30	160717.8	159537.9
HERO MOTOCORP LTD.	9795.60	8241.60	12381.1	16384.5
BOSCH LTD.	5848.00	4925.00	6367	4264
MRF LTD.	19637.60	15667.50	13685.4	15385.5
ASHOK LEYLAND LTD.	11263.50	6511.60	4488.6	2618.6
TVS MOTOR COMPANY LTD.	10094.50	10353.90	6324.3	5922.6
FORCE MOTORS LTD.	4981.10	3241.40	2352.9	2378.1
	369134.58	357781.40	298858.00	281994.60

Mid-cap



A consistent rising trend is witnessed for mid-cap auto companies from 2016 till 2019. The capex figures rose by 23% from INR 2366 million to INR 2923 million. These OEMs are likely to start making induced investments towards the technology shift now, rather than playing a wait and watch game. The real challenge faced by these OEMs was in providing BS VI-compliant vehicles to the end consumers at affordable prices.

Small-cap



For small-cap companies, the growth in capex was normal from FY16 to FY17, however, between FY17 and FY18, the figures showed an upward trend as the companies customised basis the needs of the customers and adapted new technologies and machinery. However, an uncertain FY19 led to a 94% decline. There is a lot of uncertainty about how COVID-19 will change the investment climate of small cap auto companies.

Growth between FY18 to FY19 was minimal due to the following reasons:

Economic slowdown	**Decline in private investments**	**Banking crisis that made it difficult to access credit**
Push for transition to EVs	**Tight liquidity across the aftermarket dealer channel**	**Increasing fuel prices**

Changing dynamics: Automation and EVs

The significant increase in customer needs for cyber security and automation has kept the capex investment figures high for all companies in FY17 and FY19. As companies invested in research and development, and made long-term plans related to sales and operations, figures showed a rising trend.

Challenges

However, 2W manufacturers need to increase their capex figures. Manufacturers, with a capacity of up to 150 cc, account for approximately 88% of the overall 2Ws production in India. The target to electrify all these 2Ws by 2025 is a herculean task for companies. In order to meet the demand, OEMs will need to maintain high capex figures and develop machinery and labour. The 3Ws manufacturers too need to increase their capex figures as demand shifts from traditional energy sources to new sources. The OEMs will have to capture emerging technologies and focus on producing products that are environment-friendly and also BS VI-compliant.

Our view

The growing capex trend will create opportunities for automation suppliers in India. While the impact of the pandemic will have to be assessed continuously, tighter financial conditions could trigger destabilisation in more vulnerable pockets of the country. Emerging markets remain most vulnerable, however, strong balance sheets of automobile manufacturers will insulate credit profiles to some extent. The automobile industry will tread with caution when it comes to fresh investments in the sector.

* For our analysis, we have considered only those companies which were listed on S&P Capital IQ before Q4 FY20.
* A company incurs capital expenditure (capex) to acquire or upgrade physical assets, including property, plant, and equipment.

Used or pre-owned car market in India

The Indian used car market was valued at USD 24.24 billion in 2019, and it is expected to register a CAGR of 15.12% between 2020 and 2025.

Over the years, the used car market has evolved within the country, with the growth of both organised and semi-organised sector. The pre-owned car or used car market crossed the 4 million units mark in FY18, which establishes that the used car market is 1.3 times of the new car market. One among the key growth drivers of this market is revision of the GST rate on used cars from 28% to 12-18%.

As the industry looks to manoeuvre towards BS VI compliances, the value proposition of used car could grow stronger, as new cars could become expensive due to additional technology costs. Experts opine that companies that specialise in reducing the assembly of diesel cars, for instance, Maruti Suzuki's decision to exit the diesel car segment by April 2020, could also increase the demand for compact diesel cars in the used car market.

Major players dominating the pre-owned cars market

The organised sales channel has witnessed significant growth over the last three years driven by increased sales of used cars in metro cities and a rise in online sales platforms, such as CarDekho, Cars24, Droom, etc. Majority of the OEMs have already entered the used car market and those who haven't entered in the nascent stages have also entered the market during the last five years.

Additionally, the online used car sellers have also registered good sales during 2017-19. CarDekho has been a pioneer in the online used car market recording a y-o-y growth rate of about 100% over the last three years.

Factors such as standardised dealership experience, fair price experience, and high financing cost for used cars, may hinder the growth of the used car market.

Luxury-used cars: Growing preferred choice of consumers

The used car market has witnessed a boom within the country because of the rising demand for luxury-used cars. According to OLX, over 55,000 luxury cars (priced above INR 15 lakh) were listed on OLX every month and supply for premium cars jumped by over four times in 2017. As per the report, titled OLX Auto Note, top-end sedans and luxury cars added up to 38% of the total four-wheeler listings on the platform.

Some major factors driving the growth of this segment are – high rate of depreciation value, fast growing base of young population, increasing disposable income of the consumers (along with rapid urbanisation), and growing internet penetration in non-metros.

Our view

Despite a pandemic gripping the nation and one of the worst slowdowns in two decades, the used car market is expected to grow especially with the online channels becoming more organised. Automobile dealers expect the demand for used luxury cars to grow at approximately 35%-40% y-o-y basis. With owners of luxury cars selling off their vehicles after a year or two in a bid to upgrade and rising consumer disposable incomes, most buyers are not hesitant to spend on such goods and services.

Technological advancements in automobiles

Advances in sensor technology that enhance navigation and object detection, advanced braking systems, image processing algorithms, and machine vision have created opportunities for automobile manufacturers to explore a wide range of automobile electronics solutions.

Vehicle connectivity is considered crucial in the development of the Internet of Things (IoT). Besides apps that can speak to each other, future connected vehicles will connect with the surrounding environment and as a result, lead to business opportunities with the help of data collected.

Radar, vision and LiDAR (Light Detection and Ranging) system technologies can be expected to have a high impact in making vehicles fully autonomous with enhanced safety features. Advancements in electronic control units (ECUs), powertrains can be expected to fast-track the adoption of EVs.

Automobile engineers are working on developing such technologies and companies are building and enhancing capabilities for image recognition and processing to help make journeys in self-driven vehicles secure. Miniaturisation of electronic components, product convergence, and smart device adoption facilitate developments in the industry.

The emergence of hybrid vehicles is paving the way for more environmentally acceptable alternative to fossil-fuel based vehicles. Such vehicles could now have a range useful to most commuters. A more robust network would help popularise this form of vehicle among the masses.

Our view

From an industry standpoint, the challenge today is to make electronic systems more reliable and at the same time, meet the automobile regulatory requirements. Several developments are happening in the field of ride-hailing vehicles, which can easily recognise the preferences of passengers and make their journey more comfortable. However, the global pandemic might lead to consumers being reluctant to use shared vehicles. Overall, the use of technology in automobiles is expected to increase manifold as artificial intelligence becomes the buzzword and transforms the processes.

Auto M&A deals

The merger and acquisition (M&A) plans of India Inc. were hit hard due to the COVID-19 crisis. As the market crash took a toll on valuations of most firms, cross-border transactions too have been severely impacted. The global lockdown has made matters worse.

M&A activity in progress

Sale of
100% stake
in **Air India**

Sale of
GVK's power project
Punjab to **Deutsche Bank**

Sale of
53% stake
in **BPCL by GoI**

TVS motor company acquires
Norton Motorcycles
for 16 million pounds

Our view

M&As would slow down as disruption in businesses could lead to an adverse impact on the target company's financial position. At least in the short-term, corporates have to face tough strategic choices mainly due to reduced lending by banks and consequent reallocation of surplus funds. The systemic long-term issues would also require sustained focus and redressal from the industry. Also, from a legal standpoint, there will likely be consequent changes and fundamental shifts in the M&A landscape. Buyers too are expected to seek downward price adjustments.

Regulatory updates

Union Budget 2020

Key announcements/highlights

Scheme for manufacturing of electronic equipment and semi-conductors to attract foreign investments and help EV manufacturing for encouraging newer technologies like connected platform

INR 1,000 crore handholding scheme for mid-sized companies including those in auto components will give a thrust to exports, R&D and technology absorption

Auto component industry significantly dominated by MSMEs; provision for access to working capital through new scheme will enable them to remain competitive

Increase in rates of CBUs – CVs, commercial EVs, semi-knocked down (SKD) rates on EVs will encourage localisation

The proposed Niryat Rin Vikas Yojana (NIRVIK) scheme to provide enhanced insurance cover; reduced premium will boost credit availability to component exporters

Creation of Unified Procurement System in the country in the government e-Marketplace for providing a single platform for procurement of goods, services and works. A great opportunity for MSMEs

The industry was hoping for strong revival measures from the government in the Union Budget 2020. Reduced GST rate, reduction of customs duty on certain parts for EVs, rollout plan for a scrappage policy to encourage purchase of new vehicles by replacing old ones – were among the few anticipated measures.

The industry was already reeling under challenges from the previous year. Easing of crude prices had helped to reduce the current account deficit and imports had contracted sharply than exports in the first half of the fiscal. Further, as most vehicle purchases were financed by non-banking financial companies (NBFCs), particularly in rural India, the dealers depended on NBFCs to fund their wholesale purchasing of vehicles from OEMs. With the NBFCs coming under crisis resulting in cautious lending, automobile sales bore the brunt. As the industry hoped for some positive outcome in the new year, a crisis like no other had emerged in the form of a global pandemic.

Our view

The Union Budget 2020 announced a long-to-medium-term remedy. The focus was primarily on digitising India - implementation of technology in umpteen sectors, infrastructure and accelerated development of highways. The allocation of INR 1.7 lakh crore on the infrastructural development would enable better connectivity with key industrial corridors. The thrust on sustainability and climate change is a move in the right direction. The increase in customs duty for CKDs and SKDs of EVs and CBUs of CVs are going to boost the Make in India initiative.

Measures to set up renewable energy stations would prove helpful for the required power generation as the industry transitions towards EVs. Keeping future connected cars in mind, a policy that enables the private sector to build data centre parks would be yet another measure to help enhance connectivity and digitisation. Overall, with not many specific measures for the automobile sector, the government has displayed the belief that the downturn faced by the industry is temporary and things will gradually improve. It is, thus, hoped that the immediate traction required by the sector is provided by the end customers with higher disposable incomes and by increased investments in the domestic EV space.

More vehicle safety norms make roads safer

The highest number of vehicle safety norms were made mandatory for compliance in 2019, making automobile in India safer and in line with the global standards in practice

India is at the top of automobile fatalities in the world. However, the year 2019 saw the most number of safety norms being incorporated in the country that could certainly bring down the percentage of fatalities.

The Ministry of Road Transport and Highways has adopted crash tests for all kinds of PVs sold in the country. In line with the New Car Assessment Programme (NCAP) of other countries, the Bharat New Vehicle Safety Assessment Programme (BNVSAP) has taken the country-made cars on par with the ones manufactured in developed markets.

A snapshot of critical safety norms for the automobile industry:

Compulsory fitment of anti-lock brakes (ABS) for cars and Combi-Braking System (CBS) for two-wheelers was in use for all the new 2Ws introduced after 1 April 2018. It now extends to all existing models sold in the market. The latest regulation is now also applicable for all cars on sale, including older models, from April 2019.

A **driver and co-driver seat-belt reminder alarm** is an audio warning that should be active until both the driver and the front passenger are belted up.

Reverse sensors get activated when the reverse gear is engaged, providing an audio warning of the objects in the vicinity of the vehicle.

As per these new crash-test standards, vehicles have to undergo tests for full-frontal impact at 48KPH, offset-frontal impact with a fixed deformable barrier at 56kph, and side-impact with a mobile deformable barrier at 50kph. As a result, most automakers in India had to re-engineer or phase out older models to comply with the new crash standards.

The **driver-side airbag** was made a standard fitment on all cars manufactured from 1 July 2019.

The **speed warning system** produces beep alert sound every 60 seconds when the car is running at above 80kph speed, and continuous sound above 120kph level. As per the provisions, the system cannot be overridden or turned off.

The **three-point front seat belts**, work as passive safety support, need to be buckled for effective airbags deployment.

Crash test norms compliance: Rigid requirements for full-frontal impact, offset-frontal impact, and side-impact were introduced for all newly-launched PV models introduced after October 2017. The same requirements became applicable for all new cars on sale in India from October 2019.

Additionally, **pedestrian safety norms** were also made mandatory for all newly launched cars from October 2018 and will be extended to include all cars from 2020.

Key headlines of the quarter

EV sales jump 20% in FY20; electric scooters sold most in India

Business Today: 20 April 2020

Of the electric two-wheelers sold in FY19-20, 97% were electric scooters and a very small volume of motorcycles and electric cycles that accounted for the remaining 3%. The EV industry is taking shape and despite COVID-19, FY21 will be a defining year for all the EV segments.

Eicher Motors' Royal Enfield invokes force majeure clause to select vendors

ETAuto: 31 March 2020

The move reflects the acute distress the industry is going through after a nationwide lockdown forced by COVID-19 crisis resulted in shutting of manufacturing facilities and dealerships for automobile companies.

MoRTH amends MV rules mandating adherence to AIS-155 to enhance vehicular security

IBEF: 24 December 2019

The Ministry of Road Transport & Highways (MoRTH) in a notification dated 18 December 2019, has notified that the manufacturers affixing microdot identifiers in motor vehicles and their parts, components, assemblies, sub-assemblies shall conform to Automotive Industry Standards (AIS)-155 as amended from time to time.

Automakers seek tax cut to boost demand post coronavirus outbreak

Business Today: 19 April 2020

Automakers in India want a temporary tax cut on cars, trucks and motorbikes as well as incentives to scrap old vehicles to boost sales and generate revenue after the coronavirus outbreak has brought the economy to a standstill. Companies want a temporary 10% cut in tax on the sale of all automobiles and auto parts and incentives, in the form of tax rebates, for car owners to scrap their old vehicles, SIAM said in a media statement.

In Phase-II of Fame India Scheme, 2636 EV charging stations sanctioned

IBEF: 6 January 2020

To give further push to clean mobility in road transport sector, Department of Heavy Industries has sanctioned 2636 charging stations in 62 cities across 24 States/UTs under FAME India (Faster Adoption and Manufacturing of Electric Vehicles in India) scheme phase II. The sanction letters to the selected entities will be issued in phases after ensuring the availability of land for charging stations, signing of necessary agreements/MoU with concerned partner organisations. Subsequently, each selected public entity is required to initiate the procurement process in a time bound manner for deployment of sanctioned charging stations.

MOU signed for establishing 75 EV charging stations in SDMC area

IBEF: 28 November 2019

Energy Efficiency Services Limited (EESL), a joint venture under Ministry of Power has signed a Memorandum of Understanding (MoU) with South Delhi Municipal Corporation (SDMC) to establish infrastructure for Electric Vehicles (EV) in SDMC area over a 10-year period. Under the terms outlined in the MoU, SDMC and EESL shall jointly work to fast-track the adoption of e-mobility in Delhi by installing around 75 public charging stations in SDMC area.

Lockdown to cost auto component industry INR 1000-1200 crore loss per day

ETAuto: 27 March 2020

The auto component industry is staring at production loss of INR 1000-1200 crore per day due to the nationwide lockdown imposed by the government to check the spread of the coronavirus pandemic.

Conclusion

A sharp decline in the demand for domestic vehicles in 2019 had forced the automakers to cut production throughout the year. There were expectations of revival in sales numbers from October 2019 given the Indian festive season. However, the encouraging spike in sales was witnessed in Q3 stimulated by promotional offers, aggressive discounts, new model launches, and increasing availability of BS VI-compliant models, but the volumes had dipped soon after the season was over.

The market expected a negative month-on-month sales trend to continue in Q1 2020. Despite continued difficulties faced by OEMs, the overall y-o-y decline was expected to be moderate over the rest of the year, with high anticipation of economic interventions and industry stability. However, the COVID-19 pandemic has affected the industry.

Going forward, if the situation persists till June 2020, the sector could face pressures from both demand and supply sides including in exports. Against a backdrop of falling domestic sales and continuing margin pressure, any supply-side shocks could bring the credit metrics of automobile companies under further strain.

Even as this global public health crisis reaches a peak in many countries, a majority of Indian OEMs and component companies are making efforts to restart temporarily shut down plants later in the first week of May 2020.

Despite lockdown, red zones with highest number of detected cases have been reported across Maharashtra- a major automobile hub. India is yet to reach its apex of Corona infections. The ongoing crisis will help the industry learn new lessons, especially, with respect to risk management. It would be worth taking a path that would help the industry in de-risking the supply chain and increasing preparedness for uncertainty.

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